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Recent Developments: United States, Petitioner v. American Bar Endowment et al.: Supreme Court Finds Charitable Organization's Insurance Program Taxable

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agreed that the natural father should be considered the primary source for child support and recognized that caution must be exercised when imposing child support liability on a non-biological father. In addition the dissent, like the majority, believed that an estoppel may arise even when there is no intent to mislead, if the actions of one party cause a prejudicial change in the welfare of another. However, the dissent disagreed with the majority's reasoning that financial detriment is the only type of detriment, such being the sole reason the majority denied the application of equitable estoppel. *Id.* at 541, 510 A.2d at 556.

The dissent concluded that emotional detriment should be sufficient to establish the element of detriment, and the facts in *Knill* supported a finding of emotional detriment. *Id.* at 547, 510 A.2d at 559. In light of the circumstances in *Knill*, the dissent observed the duration of the husband's representations to determine whether a true paternal relationship developed between Charles and Stephen. Moreover, the frustration of the realistic opportunity to discover and establish a relationship with the natural father was considered. Finally, the dissent noted the devastating effect on a child's welfare where a long established paternal relationship has been breached resulting in the child being proclaimed a bastard and left without a father. The dissent ultimately determined that detriment was in fact established, and therefore Charles should have been precluded from disavowing parental responsibility for child support. *Id.* at 554, 510 A.2d at 560.

In *Knill*, the court stated that since statute of limitations no longer exist in paternity suits Cledythe could maintain a successful paternity action against Stephen's natural father. Furthermore, even though Charles knew Stephen was not his son, the conduct which he demonstrated was consistent with Maryland's public policy of strengthening the family unit. Maryland encourages such conduct so long as it does not interfere or deprive the child or mother of the right or opportunity to seek legal support from the natural father.

In Maryland, as in the majority of other jurisdictions that have addressed this issue, a husband may not be equitably estopped from denying child support to an illegitimate child. In *Knill*, a case of first impression, the dissent would have considered whether the paternal relationship did, in fact, exist. The end result in *Knill* is that Charles Knill, who voluntarily assumed the role as a father, has no legal duty to support Stephen. But in the final analysis Stephen will suffer the "ultimate humiliation of having no support from a man who for all purposes was his father for fourteen years." Brief for Appellee at 6.

– William James Morrison, III

United States, Petitioner v. American Bar Endowment et al.: SUPREME COURT FINDS CHARITABLE ORGANIZATION'S INSURANCE PROGRAM TAXABLE

The Supreme Court recently upheld a tax assessment by the IRS against the American Bar Endowment (ABE) concerning income received from an insurance plan made available to its members. In *United States, Petitioner v. American Bar Endowment et al.*, 106 S.Ct. 2426 (1986), the Court decided two issues related to the particular plan. First, whether income derived from the insurance plan constituted "unrelated business income" subject to tax under §§511 through 513 of the Internal Revenue Code (Code), 26 U.S.C. §§511-513, and second, whether the members who participated in the plan could claim a charitable deduction for those premium payments which amounted to dividends on behalf of the ABE.

The ABE is a corporation exempt from taxation because it is "organized and operated exclusively for charitable . . . or educational purposes." 26 U.S.C. §501(c)(3). In order to fund its charitable work, the ABE provides group insurance policies to its members. By purchasing insurance as a group, the ABE has bargaining power that an individual would lack. Furthermore, the cost of the insurance to the group is less because it is based on the group's claims experiences instead of general actuarial tables. Normally, the cost of this plan to the insurance company is less than the premiums paid by the ABE, thereby entitling the ABE to a "dividend." Instead of dispersing the amount of the dividend among the participating members, the ABE retains the whole dividend amount to aid its fund-raising efforts. Members are required to agree to this arrangement as a condition to participation in the insurance plan. They have also been advised by the ABE that relinquishment of the dividend constitutes a tax-deductible contribution to the ABE, thereby making the after-tax cost of the insurance, "less than the cost of a commercial policy with identical coverage and premium rates." 106 S.Ct. at 2429.

The ABE was assessed a tax deficiency after an audit by the IRS in 1980. Its insurance plan was considered an "unrelated trade or business" such that any profits realized were subject to tax. 26 U.S.C. §§511-513. The ABE paid the taxes assessed, and then brought an action in the Claims Court for a refund after all administrative remedies had been exhausted. Individual participants who had not yet taken a deduction for the excess premiums paid brought an action for refunds as well. The two suits were consolidated for trial in the Claims Court.

The Claims Court found in favor of the ABE in its suit, holding that its insurance plan did not constitute a "trade or business" for purposes of the tax. The court's conclusion was based on the following four factors:

(1) The program was developed as a means of raising funds for the ABE's educational efforts.
(2) The program's success in generating dividends evidenced noncommerical behavior.
(3) Together, participants could change the program to reduce premiums.
(4) The ABE was not in competition with other non-charitable companies because it did not underwrite or act as a broker.

In the individual respondent's action, the court held that they had failed to show that the insurance was purchased at a greater price "with the intention that the excess be used to benefit a charitable enterprise," and were thus denied a charitable deduction. 4 Cl.Ct. 415 (1984). On appeal, the Court of Appeals for the Federal Circuit affirmed the decision of the Claims Court as to the ABE, but reversed and remanded the decision as to the individual respondents for further fact-finding. The Supreme Court granted the Government's petition for certiorari on both issues.

I. In a six to one decision, the Court held that the insurance program offered by the ABE constituted a trade or business for purposes of the unrelated trade or business tax. By definition, the Code sets up a three-part test for determining whether a trade or business carried on by a tax-exempt organization should be taxed. In its discussion, the Court found that the ABE's insurance program is regularly carried on, that it is not substantially related to the purpose of the ABE's tax-exempt status, and that its activity is both "the sale of goods" and "the performance of services." Thus the three-part test is satisfied. Furthermore, the program possesses the characteristics of services provided by other entities for a profit. After this initial conclusion, the Court went on to strike down three of the four factors relied on by the Claims Court in its holding.

As to the program's success in generating dividends, the Court found this to be a

result of monopoly pricing based on the unique asset available to the ABE – its members who possess "highly favorable mortality and morbidity rates." 106 S.Ct. at 2429. In discussing the third factor – that the participants could collectively change the nature of the program – the Court looked at the agreement itself which *requires* assignment of the dividend as a condition to participation in the program. The Court rejected the argument that the assignment was voluntary because members could change the policy at any time, stating that the Claims Court had put too much weight on such an unsubstantiated argument. Finally, the Court held that the ABE's program was "an example of precisely the sort of unfair competition that Congress intended to prevent" by enacting the unrelated business income tax.

> If the ABE's members may deduct part of their premium payments as a charitable contribution, the effective cost of ABE's insurance will be lower than the cost of competing policies that do not offer tax benefits. Similarly, if ABE may escape taxes on its earnings, it need not be as profitable as its commercial counterparts in order to receive the same return on its investment. Should a commercial company attempt to displace ABE as the group policyholder, therefore, it would be at a decided disadvantage.

106 S.Ct. at 2432. The only factor in the ABE's favor was that the insurance plan was consistently presented as part of its fund-raising effort. However, the Court felt that this factor could not stand alone as a basis for overturning the assessment by the IRS.

II. The Court upheld the finding of the Claims Court regarding the individual participant's claim for a charitable deduction. The fact that the respondents received a benefit from their contribution did not automatically make the premium payments non-deductible. Had any of the claimants demonstrated that the contributions were purposely made "in excess of the value of any benefit" received in return, then some deduction may have been allowed under §170 of the Code. However, none of the respondents in the action offered any proof that similar policies could have been purchased for a lower cost. Such a lack of proof led the Court to assume "that the value of ABE's insurance to those taxpayers at least equals their premium payments." 106 S.Ct. at 2434. Thus, no charitable motivation could be found by the Court.

In his dissenting opinion, Justice Stevens' main argument concerned the viability of the Court's analysis regarding the ABE program and its effect on unfair competition. In focusing his argument on the Court's failure to justify its conclusion with any concrete evidence, Justice Stevens remarked,

> The trial judge scoured the record for evidence pointing to a harmful effect on competition and found none (footnote omitted). The absence of evidence in the record, rather than the Court's ruminations about possibilities and likelihoods, should control our analysis. 106 S.Ct. at 2436.

Justice Stevens went on to refute the Court's other findings regarding the participants involuntary assignment of the dividends, the taint of a monopoly by the ABE, and the lack of a factual basis behind the charitable participation of the members, concluding that the decisions of the court of appeals and the claims court were correct.

The decision in *United States, Petitioner v. American Endowment et al.*, represents yet another clarification of the Internal Revenue Code; this time affecting members of the legal community because of the Court's interpretation of what constitutes a trade or business for purposes of the unrelated business tax.

– Barbara E. Wixon

MacDonald v. Yolo County: THE SUPREME COURT REEXAMINES THE CONCEPT OF INVERSE CONDEMNATION IN DETERMINING WHETHER AN UNCONSTITUTIONAL TAKING WITHOUT COMPENSATION HAS OCCURRED.

In *MacDonald v. Yolo County*, 54 U.S.L.W. 4782 (U.S. June 25, 1986) (No. 84-2015), the Supreme Court of the United States in a 5-4 decision delivered by Justice Stevens reaffirmed *Agins v. City of Tiburon*, 447 U.S. 225 (1980), in holding that absent knowing the nature and extent of permitted development, the Court cannot adjudicate the constitutionality of a regulation that proports to limit it; in essence because limiting intense development does not prohibit all economic use of the land sought to be developed.

In 1975, appellants submitted a tentative subdivision map to the Yolo County Planning Commission and County Board of Supervisors proposing to construct a 159-home subdivision on land which was in part a corn field. Both the Yolo County Planning Commission and the County Board of Supervisors, appellees, rejected the subdivision plan. The Board based their rejection on what they considered numerous factors "inconsistent with the General Plan of the County of Yolo, (and) the specific plan the County of Yolo embodied in zoning regulations for the County." *MacDonald*, 54 U.S.L.W. at 4782. These included: 1) the lack of access to and from the subdivision to a public street; 2) no provision for public sewer service by any government entity; 3) inadequate police protection for the subdivision; and 4) no provision for water or maintainance of a water system by any governmental entity. *Id.*

As a result of the Board's decision, the appellants claimed inverse condemnation and sought a declaratory judgment and monetary relief.

Inverse condemnation exists when a governmental entity restricts land use through regulation, such as by prohibiting development, but does not condemn the land thereby removing the landowner's remedy of just compensation. *Agins*, 447 U.S. at 255. The appellants accused the Board of "restricting the property to an open-space agricultural use by denying all permit applications, subdivision maps, and other requests to implement any other use, and thereby of appropriating the 'entire economic use' of [their] property 'for the sole purpose of [providing] . . . a public, open-space buffer.'" *MacDonald*, 54 U.S.L.W. at 4782. Appellants concluded that the Board's ruling on the regulations denied any beneficial use of their property, thus it was an unconstitutional taking without just compensation, or inverse condemnation. *Id.* at 4783.

The California Superior Court sustained appellees demurrer citing the alternative uses appellants could make of their land under the Yolo County Code §§8-2.502, .503. *Id.* Quoting *Agins*, the Court concluded that "irrespective of the insufficiency of the appellant's factual allegations, monetary damages for inverse condemnation [based on land use regulations] are foreclosed. . . ." *MacDonald*, 54 U.S.L.W. at 4783.

The California Court of Appeals affirmed the superior court's application of *Agins* where monetary damages for inverse condemnation are not permitted in California. *MacDonald*, 54 U.S.L.W. at 4783. The court stated that a landowner cannot recover "in inverse condemnation based upon land use regulation." *Id.* In further tying the facts in this action to that in *Agins*, the court offered that the only remedy available to appellants would be to set